# GERMANY

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

## Key Economic Indicators

(Billions of U.S. Dollars unless otherwise indicated)

| | 1996 | 1997 | 1998 1/ |
|---|---|---|---|
| *Income, Production and Employment:* | | | |
| Nominal GDP 2/ | 2,349 | 2,095 | 2,109 |
| GDP Growth (pct) 3/ | 1.3 | 2.2 | 2.7 |
| GDP by Sector (pct): | | | |
| Agriculture | 1.5 | 1.5 | N/A |
| Manufacturing | 33.7 | 33.8 | N/A |
| Services | 48.7 | 49.3 | N/A |
| Government | 13.4 | 13.0 | N/A |
| Per Capita GDP (US$) | 28,667 | 25,549 | 25,675 |
| Labor Force (000's) | 34,423 | 33,962 | 34,095 |
| Unemployment Rate (pct) | 10.2 | 11.4 | 10.3 |
| *Money and Prices (annual percentage growth):* | | | |
| Money Supply Growth (M2) | 4.6 | 1.1 | N/A |
| Consumer Price Inflation | 1.5 | 1.8 | 1.0 |
| Exchange Rate (DM/US$ annual average) | 1.50 | 1.73 | 1.78 |
| *Balance of Payments and Trade:* | | | |
| Total Exports FOB 4/ | 526.0 | 513.7 | 544.7 |
| Exports to U.S. 4/ | 40.1 | 44.3 | N/A |
| Total Imports CIF 4/ | 460.3 | 446.3 | 463.4 |
| Imports from U.S. 4/ | 33.0 | 33.8 | N/A |
| Trade Balance 4/ | 65.7 | 67.4 | 81,3 |
| Balance with U.S. | 7.1 | 10.5 | N/A |
| Current Account Balance/GDP (pct) | -0.6 | -0.2 | 0.2 |
| External Public Debt | 411 | 408 | N/A |
| Fiscal Deficit/GDP (pct) | -3.5 | -2.8 | -2.3 |
| Debt Service Payments/GDP (pct) | 3.7 | 3.7 | 3.7 |
| Gold and Foreign Exchange Reserves | 57.2 | 52.2 | N/A |

| | | | |
|---|---|---|---|
| Aid from U.S. | N/A | N/A | N/A |
| Aid from All Other Sources | N/A | N/A | N/A |

1/ 1998 Figures are all estimates based on available monthly data in October and consensus forecasts.
2/ GDP at factor cost.
3/ Percentage changes calculated in national currency.
4/ Merchandise trade.

*1. General Policy Framework*

Germany's economy is the world's third largest, equivalent to just over two trillion dollars (in nominal terms). Real GDP growth, which reached 2.2 percent in 1997, continued to strengthen through 1998. Most German public and private forecasters estimate growth of around 2.7 percent for 1998 and a slightly lower growth rate in 1999. This expansion is largely fueled by higher exports and, to a lesser extent, by higher equipment investment. Private consumption has picked up somewhat in 1998, but slow growth in the construction sector continued to provide a drag on the overall economy.

In an October 1998 report, leading private economic institutes forecast that growth will be stronger in western Germany than in the east, stopping -- at least temporarily-- progress toward economic convergence within Germany. Unemployment remains high throughout the country. In eastern Germany, the unemployment rate increased to 16.9 percent in 1998. Despite a modest decrease in the unemployment rate in western Germany, which was largely due to short-term job creation programs, the number of unemployed for all of Germany will be approximately 4.3 million for 1998.

The German "social market" economy is organized on market principles and affords its citizenry a secure social safety net characterized by generous unemployment, health, educational and basic welfare benefits. Increased government outlays associated with German unification have put pressure on fiscal policy during the 1990s. The country's generous social welfare system was extended as a whole to eastern Germany, and the government further committed itself to raise eastern German production potential via public investment and generous subsidies to attract private investment. However, overall unit labor costs in eastern Germany are still quite high, as productivity growth has lagged behind wage increases. This has resulted in heavy job losses and greatly increased Germany's unemployment compensation costs. As a result, western Germany continues to transfer substantial sums to eastern Germany (more than DM 140 billion annually, or roughly four percent of German GDP). These transfers have accounted for the dramatic ballooning of public sector deficits and borrowing since 1990.

The new government elected on September 27, 1998 has indicated that its highest priority will be to lower unemployment. It also intends to introduce modest reforms in the income tax system over a period of four years, largely benefiting lower income taxpayers and providing only slight overall net tax relief. The new government has also committed itself to keeping the public sector deficit within the limits set in the general Maastricht Agreement.

In the early 1990s, relatively high rates of inflation (the consumer price index rose an average 4.8 percent in 1992 and 1993) and money growth, upward pressure on wages, and fiscal deficits preoccupied the German Central Bank (Bundesbank). The Bundesbank places overriding importance on price stability and thus responded to the rising inflation in 1991/92 by hiking short-term interest rates, which peaked in July 1992 at post-war highs. Since then, the central bank discount rate has declined by 6.25 percentage points, with the most recent cut, to a historic low of 2.5 percent, occurring in April 1996. The new government has called for a further reduction in interest rates to stimulate demand and reduce unemployment. Wage settlements in 1998 have been moderate and unit wage costs have continued to decline. Labor unions indicate they will push for more generous wage settlements in 1999. At the same time, inflation continues to moderate, with consumer price inflation reaching a new low in August, 1998, rising only a provisional 0.8 percent year-on-year. The overall increase in consumer prices may average less than one percent for 1998 as a whole.

The government's public sector deficits are financed primarily through sales of government bonds, the maximum maturity of which normally is ten years, although 30-year bonds are occasionally sold. The Bundesbank's primary monetary policy tool is short-term liquidity provided to the banking system via repurchasing operations, at a "repurchasing" rate that the Bundesbank largely determines. To preempt inflationary pressures, the Bundesbank raised this rate by 30 basis points in October 1997 to 3.30 percent. The Frankfurt-based European Central Bank took over monetary policy control in January, 1999 with the introduction of the euro, and has indicated it will follow the general policy trends of the Bundesbank.

*2. Exchange Rate Policies*

The Deutsche Mark is a freely convertible currency, and the government does not maintain exchange controls. On January 1, 1999, the euro was introduced in Germany. Over the next three years, the DM will be phased out and the euro will become the exclusive currency in Germany. All monetary and exchange policies will be handled by the European Central Bank.

*3. Structural Policies*

Since the end of the Second World War, German economic policy has been based on a "social-market" model which is characterized by a substantially higher level of direct government participation in the production and services sector than in the United States. In addition, an extensive regulatory framework, which covers most facets of retail trade, service licensing and employment conditions, has worked to limit market entry by not only foreign firms but also German entrepreneurs.

Although the continuation of the "social market" model remains the goal of all mainstream political parties, changes resulting from the integration of the German economy with those of its European Union partners, the shock of German unification, pressure from globalization on traditional manufacturing industries, and record high unemployment have forced a rethinking of the German post-war economic consensus and spurred intense public debate on Germany's competitiveness as a location for business and investment.

A number of structural impediments to the growth and diversification of the German economy have been identified. These can be broadly grouped as follows:

(1) a rigid labor market;
(2) a regulatory system that discourages new entrants;
(3) high marginal tax rates and high social charges;
(4) and, inadequate access to risk and venture capital for start-up firms.

The new government is focusing its efforts on combating unemployment. It is not yet clear how and to what extent it intends to address these structural impediments.

In recent years, the government has carried out a reorganization of the German Federal Railroad and completed transforming the operating entities of the German Federal Post into stock companies. In conjunction with the liberalization of the telecommunications sector, the government-owned Deutsche Telekom was substantially privatized (25 percent of shares were made public) in what was one of the largest stock offerings in history. The German Government has fulfilled its commitment to open the telecommunications network monopoly to competition as of January 1, 1998, the date when its new Regulatory Authority for Telecommunications and Post began operation. The federal government also has sold its remaining stake in the national airline, Lufthansa.

Despite the progress in recent years, lack of competition remains a problem in many protected sectors and drives up business costs in Germany. Services which continue to be subject to excessive regulation and market access restrictions include communications, banking and insurance. The government intends to review existing legislation that limits price competition between firms, as well as laws that reduce competition in the insurance and transport sectors. The Regulatory Authority for Telecommunications has issued new regulations to encourage competition in the telecoms sector. Paralleling German Government efforts to deregulate the economy, the European Union is expected to continue to pressure its member states to reduce barriers to trade in services within the Community. U.S. firms, especially those with operations located in several European Union member states, should benefit from such market integration efforts over the long term.

*4. Debt Management Policies*

As a part of the introduction of European Monetary Union, the government is working to reduce its public sector deficits and lower its debt/GDP ratio. Germany is also subject to a constitutional limitation to hold its new net borrowing, at or below the amount invested in public sector infrastructure.

Germany has recorded persistent current account deficits since 1991 due to a dramatic drop in the country's traditionally strong trade surplus, related in part, to strong eastern German demand. These deficits have been fairly small, however, in relation to GDP, and Germany is expected to show a current account surplus this year. With demand in eastern Germany slowing and exports strengthening, the trade surplus has increased steadily, and will likely reach the high pre-unification level of some $81 billion for 1998. The strong deterioration of the services balance in recent years, caused principally by German tourism expenditures abroad, has contributed to the past current account deficits. The factor income balance has also worsened in recent years due to government interest payments to foreigners holding increasing stocks of German debt. Nonetheless, due to large current account surpluses from the 1970's until the current decade, Germany remains the world's second-largest creditor, with net foreign assets estimated at roughly $150 billion by mid-1997.

*5. Significant Barriers to U.S. Exports*

Germany is the United States' sixth-largest export market and its fifth-largest source of imports. During the first eight months of 1997, U.S. exports to Germany totaled $15.5 billion (FOB basis), while U.S. imports from Germany reached $25.6 billion (FOB basis). Other than EU-imposed restrictions, there are few formal barriers to U.S. trade and investment in Germany. Ingrained consumer behavior and the intense competition prevailing in German product and services markets often make gaining market share a difficult challenge, especially for new-to-market companies.

Import Licenses: Germany has abolished almost all national import quotas. The country enforces, however, import license requirements placed on some products by the European Union, such as the tariff quota on Latin American bananas imposed by the EU's banana import regime. As a result of this discriminatory marketing arrangement, U.S. fruit trading companies have lost market share in Germany. The World Trade Organization's dispute resolution panel and the WTO Appeals body, have found the EU banana regime to violate both the General Agreement on Trade in Services and the General Agreement on Trade in Goods, requiring EU members (including Germany) to reform this trading regime. However, the EU has so far proposed only cosmetic changes that do not bring the banana regime into compliance with WTO rules.

Services Barriers: Foreign access to Germany's insurance market is still limited to some degree. All telecommunications services have been fully open to competition since January 1998, when the EU's telecommunications market liberalization came into effect. Liberalization has opened up opportunities for U.S. telecommunications service providers. Germany has no foreign ownership restrictions on telecommunications services. An EU data privacy directive came into force on October 25, 1998. The directive prohibits businesses from exporting "personal information" unless the receiving country has in place privacy protections that the EU deems adequate. The U.S. and the EU are engaged in ongoing discussions to establish “safe harbor” principles as a way to allow the continued free flow of data.

Standards, Testing, Labeling, and Certification: Germany's regulations and bureaucratic procedures are complex and can prove to be a hurdle for U.S. exporters unfamiliar with the local environment. Overly complex government regulations offer -- intentionally or not -- local producers a degree of protection. Health and safety standards, for example, when overzealously applied, can restrict market access for many U.S. products (e.g., genetically modified organisms). The European Union's attempts to harmonize the various product safety requirements of its member states have further complicated the issue. Existing German standards will likely form the basis in a number of cases for eventual EU standards.

Government Procurement: In May 1998, the government passed the Public Procurement Reform Act. It establishes examining bodies that have the responsibility to review the awarding of public contracts and to investigate complaints pertaining to the procurement process.

Investment Barriers: Under the terms of the 1956 Treaty, U.S. investors are afforded national treatment. The government and industry actively encourage foreign investment in Germany. Foreign companies with investment complaints in Germany generally list the same investment problems as domestic firms: high tax rates, expensive labor costs, and burdensome regulatory requirements.

Customs Procedures: Administrative procedures at German ports of entry do not constitute a problem for U.S. suppliers.

*6. Export Subsidies Policies*

Germany does not directly subsidize exports outside the European Union's framework for export subsidies for agricultural goods. Governmental or quasi-governmental entities do provide export financing, but Germany subscribes to the OECD guidelines that restrict the terms and conditions of export finance.

*7. Protection of U.S. Intellectual Property*

Intellectual property is generally well protected in Germany. Germany is a member or the World Intellectual Property Organization; a party to the Berne Convention for the Protection of Artistic and Literary Works, the Paris Convention for the Protection of Industrial Property, the Universal Copyright Convention, the Geneva Phonograms Convention, the Patent Cooperation Treaty, the Brussels Satellite Convention, and the Treaty of Rome on Neighboring

Rights. U.S. citizens and firms are entitled to national treatment in Germany, with certain exceptions. Despite Germany's implementation of its commitment under the intellectual property rights portions (TRIPS) of the Uruguay Round, some U.S. firms continue to have concerns about the level of software piracy in Germany. Germany's 1993 implementation of the EU's Software Copyright Directive, as well as an educational campaign by the software industry have helped improve Germany's performance in this area.

*8. Worker Rights*

*a. The Right of Association:* Article IX of the German Constitution guarantees full freedom of association. Workers' rights to strike and employers' rights to lock-out are also legally protected.

*b. The Right to Organize and Bargain Collectively:* The constitution provides for the right to organize and bargain collectively, and this right is widely exercised. Due to a well-developed system of autonomous contract negotiations, mediation is uncommon. Basic wages and working conditions are negotiated at the industry level and then are adapted, through local collective bargaining, to particular enterprises. Nonetheless, some firms in Eastern Germany have refused to join employer associations, or have withdrawn from them, and then bargained independently with workers. In other cases, associations are turning a "blind eye" to firm-level negotiations. Likewise, some large firms in the west withdrew at least part of their workforce from the jurisdiction of the employers association, complaining of rigidities in the centralized negotiating system. They have not, however, refused to bargain as individual enterprises. The law mandates a system of work councils and worker membership on supervisory boards, and thus workers participate in the management of the enterprises in which they work. The law thoroughly protects workers against antiunion discrimination.

*c. Prohibition of Forced or Compulsory Labor:* The German Constitution guarantees every German the right to choose his own occupation and prohibits forced labor, although some prisoners are required to work.

*d. Minimum Age for Employment of Children:* German legislation in general bars child labor under age 15. There are exemptions for children employed in family farms, delivering newspapers or magazines, or involved in theater or sporting events.

*e. Acceptable Conditions of Work:* There is no legislated or administratively determined minimum wage. Wages and salaries are set either by collective bargaining agreements between unions and employer federations, or by individual contracts. Covering about 90 percent of all wage and salary earners, these agreements set minimum pay rates and are legally enforceable. These minimums provide an adequate standard of living for workers and their families.

*f. Rights in Sectors with U.S. Investment:* The enforcement of German labor and social legislation is strict, and applies to all firms and activities, including those in which U.S. capital is invested. Employers are required to contribute to the various mandatory social insurance programs and belong to and support chambers of industry and commerce which organize the dual (school/work) system of vocational education.

**Extent of U.S. Investment in Selected Industries** -- U.S. Direct Investment Position Abroad on an Historical Cost Basis -- 1997

(Millions of U.S. Dollars)

| Category | | Amount |
|---|---|---|
| Petroleum | | 2,648 |
| Total Manufacturing | | 20,462 |
| Food & Kindred Products | 1,233 | |
| Chemicals & Allied Products | 3,927 | |
| Primary & Fabricated Metals | 1,495 | |
| Industrial Machinery and Equipment | 3,665 | |
| Electric & Electronic Equipment | 1,323 | |
| Transportation Equipment | 5,646 | |
| Other Manufacturing | 3,173 | |
| Wholesale Trade | | 2,538 |
| Banking | | 1,065 |
| Finance/Insurance/Real Estate | | 13,816 |
| Services | | 1,713 |
| Other Industries | | 1,689 |
| TOTAL ALL INDUSTRIES | | 43,931 |

Source: U.S. Department of Commerce, Bureau of Economic Analysis.